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6 **IN THE UNITED STATES DISTRICT COURT**
7 **FOR THE DISTRICT OF ARIZONA**
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9 VFS Leasing Company, et al.,

10 Plaintiffs,

11 v.

12 Silverado Stages Incorporated, et al.,

13 Defendants.
14

No. CV-18-02894-PHX-DLR

ORDER

15
16 Before the Court is Defendants James and Sharron Galusha's motion to dismiss
17 Count IV of the first amended complaint for failure to state a claim pursuant to Federal
18 Rules of Civil Procedure 9(b) and 12(b)(6).¹ (Doc. 32.) The motion is fully briefed.²
19 (Docs. 37, 43.) For the following reasons, the Galushas' motion is granted.

20 **I. Background**

21
22 ¹ Defendants Silverado Stages, Inc., Silverado Stages CC, LLC, Silverado Stages
23 NC, LLC, Silverado Stages SC, LLC, Silverado Stages NV, LLC, Silverado Stages AZ,
24 LLC, Silverado Charter Services, LLC, and Michelangelo Leasing, LLC (collectively, the
25 "Bankruptcy Defendants") filed bankruptcy on October 5, 2018 (the "Bankruptcy"). As a
26 result, Plaintiffs filed a Notice of Voluntary Partial Dismissal of (1) the Complaint as
27 Against Bankrupt Defendants Without Prejudice; and (2) the Fraud Claim as Against All
28 Defendants Except [the Galushas], which dismissed the Bankruptcy Defendants without
prejudice and dismissed the fraud claim against Defendant Silverado Stages WY, LLC.
(Doc. 28.) Accordingly, this motion is filed on behalf of the Galushas individually and in
their capacities as trustees of the Jim and Sharron Galusha Revocable Trust Dated August
9, 2012 only.

² The Galushas' request for oral argument is denied because oral argument will not
aid in the resolution of this matter. *See* LRCiv. 7.2(f); Fed. R. Civ. P. 78(b).

1 Beginning in March 2013, Plaintiffs VFS Leasing Co. and Volvo Financial
2 Services, a division of VFS US LLC, extended credit to Michelangelo Leasing, Inc.
3 (“Michelangelo”) for equipment under a series of financial agreements. (Doc. 11 ¶¶ 18-
4 32.) In 2017, Silverado Stages, Inc. (“Silverado”) and the Galushas—Silverado’s majority
5 shareholders—informed Plaintiffs that they intended to assume Michelangelo’s obligations
6 and refinance the debt (“Michelangelo Debt”). (¶ 33.) At the same time, Silverado and
7 the Galushas also sought to finance nineteen additional pieces of equipment from Plaintiffs
8 (“Additional Credit,” together with the Michelangelo Debt, the “Credit Request”). (*Id.*)

9 For Plaintiffs to evaluate the Credit Request, Silverado and the Galushas were
10 required to provide certain financial information, including a Personal Financial Statement
11 (“PFS”). (¶ 34.) The Galushas December 31, 2016 PFS identified as assets their personal
12 residence and three other real estate properties they owned as tenants in common. (¶¶ 35,
13 37.) The PFS also represented that they held assets in trust as “The Jim & Sharron Galusha
14 Revocable Trust,” but did not individually identify specific assets. (¶ 38.) The Galushas
15 and the Bankruptcy Defendants executed continuing guaranties. (¶¶ 47-48.) Based in part
16 on the Galushas representation of their personal assets in the PFS, Plaintiffs granted the
17 Credit Request. (¶ 39.)

18 On January 6, 2017, Silverado executed an assignment under which they agreed to
19 be responsible for “all obligations and performance of Michelangelo Debt[.]” (¶ 40.)
20 Beginning in June 2017, Silverado entered into a series of financial schedules under which
21 Plaintiffs agreed to extend Additional Credit. (¶¶ 41-44.) In 2017 and 2018, the parties
22 also entered into Modification Agreements to modify payments due on the Michelangelo
23 Debt. (¶¶ 45-46.) Despite the parties’ modification efforts, Silverado defaulted on the
24 agreements. (¶ 55-58.)

25 In September 2018, Plaintiffs filed this action against Silverado, the Galushas, and
26 Bankruptcy Defendants for failure to remit payments to Plaintiffs. (¶ 55.) Plaintiffs allege
27 breach of leases, loans, and continuing guaranties, in addition to common law fraud and
28 replevin. (¶¶ 64-96.) The Galushas now move to dismiss Count IV (fraud) of Plaintiffs’

1 complaint under Fed. R. Civ. P. 9(b) and 12(b)(6). (Doc. 32.)

2 **II. Legal Standards**

3 **A. Fed. R. Civ. P. 12(b)(6)**

4 When analyzing a complaint for failure to state a claim to relief under Rule 12(b)(6),
5 the well-pled factual allegations are taken as true and construed in the light most favorable
6 to the nonmoving party. *Cousins v. Lockyer*, 568 F.3d 1063, 1067 (9th Cir. 2009). Legal
7 conclusions couched as factual allegations are not entitled to the assumption of truth,
8 *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009), and therefore are insufficient to defeat a
9 motion to dismiss for failure to state a claim, *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1108
10 (9th Cir. 2010). To avoid dismissal, the complaint must plead sufficient facts to state a
11 claim to relief that is plausible on its face. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570
12 (2007). This plausibility standard “is not akin to a ‘probability requirement,’ but it asks
13 for more than a sheer possibility that a defendant has acted unlawfully.” *Iqbal*, 556 U.S.
14 at 678 (quoting *Twombly*, 550 U.S. at 556).

15 **B. Fed. R. Civ. P. 9(b)**

16 Rule 9(b) requires allegations of fraud to be pled with particularity. “To comply
17 with Rule 9(b), allegations of fraud must be specific enough to give defendants notice of
18 the particular misconduct which is alleged to constitute the fraud charged so they can
19 defend against the charge and not just deny that they have done anything wrong.” *Bly-*
20 *Magee v. Cal.*, 236 F.3d 1014, 1019 (9th Cir. 2001). The allegations must include “the
21 who, what, when, where, and how” of the misconduct charged and “must set forth more
22 than the neutral facts necessary to identify the transaction. The plaintiff must set forth what
23 is false or misleading about a statement, and why it is false.” *Vess v. Ciba-Geigy Corp.*
24 *USA*, 317 F.3d 1097, 1106 (9th Cir. 2003).

25 **III. Discussion**

26 The Galushas argue that Plaintiffs’ fraud claim should be dismissed because it is
27 barred by the economic loss rule and because Plaintiffs have not specifically plead the
28 necessary elements.

1 **A. Economic Loss Rule**

2 The economic loss rule, when applicable, acts to limit a party to contractual
3 remedies for economic losses absent physical injury to people or other property. *Flagstaff*
4 *Affordable Hous. Ltd. P'ship v. Design All., Inc.*, 223 P.3d 664, 667 (Ariz. 2010). The
5 doctrine is designed to honor parties' expectations by limiting recovery to contract
6 remedies "for loss of the benefit of the bargain." *Id.* at 671. Holding contractual parties to
7 agreed-upon remedies is appropriate when, as contract law presumes is the case, parties are
8 on equal footing and have had an opportunity during negotiations to allocate risks. *Id.* at
9 669.

10 Although "the Arizona Supreme Court's ruling fell short of expressly declaring that
11 the rule only applies in product liability and construction defect cases . . . there is little to
12 support that the Arizona courts intended the doctrine to apply outside these contexts."
13 *Firetrace USA, LLC v. Jeslcard*, 800 F. Supp. 2d 1042, 1052 (D. Ariz. 2010); *see also*
14 *Giles Const., Inc. v. Commercial Fed. Bank*, No. Civ 04-258-TUC-CKJ, 2006 WL
15 2711501, at *9-10 (D. Ariz. Sept. 21, 2016) ("Other than construction and product defect
16 cases, however, the Arizona courts have not applied the economic loss rule as a bar to the
17 recovery of economic damages in tort cases. To the contrary, Arizona courts have issued
18 numerous decisions permitting the recovery of purely economic losses in tort actions.").

19 Indeed, a formulation of the economic loss rule that eliminates recovery under all
20 tort theories is "overly broad." *Flagstaff Affordable Hous.*, 223 P.3d at 667. "[I]n the case
21 of fraud, a tort specifically designed to remedy economic harm, the doctrine is especially
22 inappropriate." *Wilson v. GMAC Mortg., LLC*, No. 11-CV-546-PHX-FJM, 2011 WL
23 4101668, at *2 (D. Ariz. Sept. 14, 2011); *see also KD & KD Enterprises*, No. CV-06-2083-
24 PHX-FJM, 2006 WL 3808257, at *2 (D. Ariz. Dec. 27, 2006) ("[D]efendants seek to
25 extend the economic loss inquiry to all torts, even those, like fraud, specifically designed
26 for economic harm. This logical leap would basically eviscerate the tort of fraud, for the
27 only damages one has in fraud are economic. The law cannot be so twisted."). "When
28 fraudulent conduct infects contract negotiations, the presumption that the parties engaged

1 in an equal negotiation evaporates. Thus, it is unreasonable to restrict a party to contractual
2 liability when fraud created an unequal bargaining environment.” *Wilson*, 2011 WL
3 4101668, at *2; *see also Giles v. Gen. Motors Acceptance Corp.*, 494 F.3d 865, 880 (9th
4 Cir. 2007) (Nevada economic loss doctrine did not bar claims for fraud); *Jes Solar Co.,*
5 *Ltd. v. Matinee Energy, Inc.*, No. 12-CV-626-TUC-DCB, 2015 WL 10943562, at *4-5 (D.
6 Ariz. Nov. 2, 2015) (declining to apply economic loss rule to fraudulent misrepresentation
7 claim).

8 Despite these authorities, the Galushas contend that the economic loss rule requires
9 dismissal of Plaintiffs’ fraud claim. The Galushas rely on *Cook v. Orkin Exterminating*
10 *Co.*, 258 P.3d 149, 150 (Ariz. Ct. App. 2011) and *Maricopa Inv. Team, LLC v. Johnson*
11 *Valley Partners LP*, No. 1 CA-CV 12-0047, 2012 WL 5894849, at *1-3 (Ariz. Ct. App.
12 2012), in which claims for fraud and intentional misrepresentation were found to be barred
13 by the economic loss rule. The economic loss rule, however “may vary in its application
14 depending on context-specific policy considerations.” *Flagstaff Affordable Hous.*, 223
15 P.3d at 669. Courts should consider the underlying policies of tort and contract law when
16 determining whether the rule applies to a particular case. Here, the Court finds that the
17 underlying policies of tort and contract law do not support application of the economic loss
18 rule in this context. *KD & KD Enters., LLC v. Touch Automation, LLC*, No. 06-CV-2083-
19 PHX-FJM, 2006 WL 3808257, at *2 (D. Ariz. Dec. 27, 2006) (holding that underlying
20 policies prohibit application of economic loss rule to fraudulent representations made in
21 contracting). The Court therefore will not dismiss Count IV on this basis.

22 **B. Elements of Fraud**

23 Under Arizona law, to state a plausible fraud claim a plaintiff must plead the
24 following elements:

25 (1) a representation; (2) its falsity; (3) its materiality; (4) the
26 speaker’s knowledge of its falsity or ignorance of its truth; (5)
27 his intent that it should be acted upon by and in the manner
28 reasonably contemplated; (6) the hearer’s ignorance of its
falsity; (7) his reliance on the truth; (8) his right to rely thereon;
and (9) his consequent and proximate injury.

1 *Peery v. Hansen*, 585 P.2d 574, 577 (Ariz. 1978). The Galushas argue that Plaintiffs have
2 not specified which representations are false or misleading and why. As a result, the
3 Galushas contend that Plaintiffs necessarily have not adequately pled the remaining
4 elements of a fraud claim because, without identifying specific misrepresentations, it is not
5 possible to assess factors like materiality, reasonable reliance, or whether the Galushas
6 knew the information was false. On this point, the Court agrees.

7 Plaintiffs generally allege that: (1) the Galushas sought the Credit Request from
8 Plaintiffs; (2) Plaintiffs informed Silverado and the Galushas that they needed to provide
9 financial information to evaluate the Credit Request; (3) the Galushas produced a PFS that
10 listed assets held as tenants in common and identified that they owned assets in trust; (4)
11 based on the assets listed in the Galushas' PFS, Plaintiffs granted the Credit Request; and
12 (5) in January 2017, Silverado agreed to assume obligations and performance of the
13 Michelangelo Debt. (Doc. 11 ¶¶ 33-40.) With respect to Count IV of the complaint,
14 Plaintiffs further allege that: (1) the Galushas provided Plaintiffs with the PFS knowing it
15 misrepresented assets; (2) Plaintiffs, without knowledge of the misrepresented assets,
16 relied upon the PFS when granting the Credit Request; (3) the Galushas misrepresentations
17 were material; (4) the Galushas were aware of Plaintiffs' reliance upon the PFS; and (5)
18 Silverado defaulted on the agreements and Plaintiffs anticipate that they will be unable to
19 collect on the debt, even after the conclusion of this lawsuit, because of the Galushas'
20 misrepresentation. (¶¶ 78-85.)

21 The PFS identifies numerous assets, however, and missing from Plaintiffs'
22 complaint are allegations specifying which assets were misrepresented and how. (Doc. 11-
23 2 at 44-47.) Without this information the Court cannot assess whether Plaintiffs have
24 plausibly alleged the remaining elements of a fraud claim. For this reason, Plaintiffs have
25 not adequately alleged fraud and the Court will dismiss Count IV. *See Bly-Magee*, 246
26 F.3d at 1019.

27 **C. Leave to Amend**

28 In their response brief, Plaintiffs argue that they should be granted leave to amend

1 if the Court determines, as it now has done, that Plaintiffs failed to adequately plead fraud.
2 (Doc. 37 at 11.) Plaintiffs' request fails to comply with the Court's October 3, 2018 order,
3 which in relevant part states:

4 1. Before the filing of any motion under Rule 12(b)(6) or 12(c),
5 the parties must confer in good faith to determine whether the
6 motion can be avoided. Defendant shall explain to Plaintiff the
7 reasons why Defendant believes the complaint fails to state a
8 claim for relief. The parties shall discuss whether any of the
9 deficiencies identified by Defendant can be cured through an
10 amended complaint. If the parties agree on this point, Plaintiff
11 shall file an appropriate amended complaint in order to avoid
12 the filing of an unnecessary motion to dismiss.

13 2. *Notwithstanding Plaintiff's belief that the complaint is*
14 *sufficient to state a claim for relief, or Defendant's belief that*
15 *the complaint is not curable, if Plaintiff believes that an*
16 *amendment can cure or address some or all of the purported*
17 *deficiencies identified by Defendant, Plaintiff is strongly*
18 *encouraged to file an amended complaint containing all*
19 *further allegations Plaintiff could make before Defendant files*
20 *a motion to dismiss or for judgment on the pleadings. This*
21 *would avoid the need for Plaintiff to seek leave to amend*
22 *should the Court determine that the motion to dismiss or for*
23 *judgment on the pleadings is well taken.*

24 3. *As an alternative to the procedure outlined in paragraph 2,*
25 *if Defendant files a motion under Rule 12(b)(6) or 12(c)*
26 *notwithstanding Plaintiff's belief that further amendment of the*
27 *complaint can cure the alleged defect(s), Plaintiff must submit,*
28 *no later than the time Plaintiff files a response to the motion, a*
proposed amended complaint that complies with LRCiv
15.1(a) and contains all further allegations Plaintiff could
make. In the event a motion to dismiss or for judgment on the
pleadings is granted in any part, no leave to amend the
complaint will be granted beyond what is offered in the
proposed amended complaint.

(Doc. 17 (emphasis added).) The point of paragraph 2 is to encourage a plaintiff, when
faced with the prospect of an unavoidable motion to dismiss, to essentially put all his cards
on the table so that the parties need brief and the Court need resolve only one motion to
dismiss. If a plaintiff declines to do so, paragraph 3 is designed to ensure that a request for
leave to amend complies with the Local Rules and to provide a defendant and the Court
with the opportunity to assess whether the amendment would be futile.

Here, Plaintiffs did not choose the procedure in paragraph 2, but also failed to
comply with the alternative procedure in paragraph 3. As a result, their request for leave

1 to amend fails to comply with LRCiv 15.1 because they have not lodged a proposed
2 amended pleading that indicates in what respect it differs from the original. Also absent
3 from Plaintiffs' motion is any explanation for their failure to abide by the Local Rules and
4 the Court's order.

5 The consequences of this failure are readily apparent. The Galushas' motion to
6 dismiss includes arguments that Plaintiffs cannot assert any plausible fraud claim based on
7 the PFS because no representations therein could have been material to Plaintiffs' decision-
8 making or caused Plaintiffs injury, and because Plaintiffs did not and could not reasonably
9 have relied on any such information. But, as previously explained, without knowing what
10 specific representations form the basis of Plaintiffs' fraud claim, the Court cannot grapple
11 with these arguments in any concrete way. These arguments might inform the Court's
12 inquiry into whether further amendment would be futile, but Plaintiffs have not offered an
13 amended pleading, so the Court still is left unable to concretely grapple with the Galushas'
14 arguments.

15 Accordingly, Plaintiffs' request for leave to amend is denied without prejudice
16 because it fails to comply with the Court's October 3, 2018 order or with LRCiv 15.1. If
17 Plaintiffs want to resurrect their fraud claim, they may file a motion for leave to amend that
18 complies with LRCiv 15.1 within fourteen days of the date of this order. The motion should
19 include an explanation for why a proposed amended pleading could not have been lodged
20 with the Court sooner.

21 **D. Attorneys' Fees**

22 Lastly, the Galushas seek an award of their reasonable attorneys' fees pursuant to
23 A.R.S. §12-341.01(A). (Doc. 32 at 15.) The Galushas' request is denied without prejudice
24 because it does not comply with LRCiv 54.2.

25 //

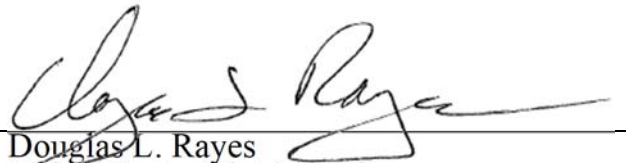
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1 **IT IS ORDERED** that the Galushas' motion to dismiss Count IV-Fraud (Doc. 32)
2 is **GRANTED** as explained herein. Count IV of the complaint is dismissed. If they so
3 choose, Plaintiffs may file a motion for leave to amend that complies with LRCiv 15.1
4 within fourteen days of the date of this order.

5 Dated this 15th day of August, 2019.

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11 Douglas L. Rayes
12 United States District Judge
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